Challenges and Opportunities Saskatchewan

Saskatchewan's Tax System for the 1990s

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Introduction

In 1988, the Government of Saskatchewan published *A Dialogue on Saskatchewan Income Tax Reform* in which the Government stated that the objectives of the provincial income tax system should be:

- consistent with widely accepted notions of equity, so that individuals and families see fairness in the system;
- consistent with overall social and economic policy objectives;
- simple enough that taxfilers do not generally require professional assistance to prepare their tax returns;
- a relatively stable source of government revenue; and,
- in harmony with the national tax system.

At the same time, the paper presented proposals regarding the personal income tax system for public discussion.

Over the last year, there has been considerable public reaction to those personal income tax alternatives. An important facet of the discussion has been the public's interest in a fairer and simpler tax system.

In addition, these discussions have made it clear that one tax system cannot be examined in isolation from others. This has been underlined by the federal National Sales Tax proposal which may have significant implications for Saskatchewan's reform initiative.

The Government continues to be committed to a meaningful and comprehensive reform of Saskatchewan's tax system. This paper continues the dialogue on tax reform by:

- reviewing the progress of tax reform made to date;
- reviewing the results of the public consultations about tax reform; and,
- describing the federal proposal for a National Sales Tax.

Saskatchewan's Corporate Tax Reform

Last year, the Government introduced a number of corporate and business tax initiatives to achieve economic development and diversification, greater fairness and neutrality, support for small business, competitive tax rates, improved revenue capacity and stability of the tax system.

Taxes paid by Saskatchewan-based industry were lowered through:

- a reduction of the general corporate income tax rate from 17 per cent to 15 per cent of taxable income, effective for 1989 and subsequent years;
- an extension of the tax holiday for new small businesses to March 31, 1990; and,
- the introduction of a program to reduce the local business tax by up to $10 million.

By removing tax preferences provided to certain entities, such as federal Crown corporations, competitive imbalances in the tax system were removed.

The Corporate Capital Tax Surcharge on large resource corporations was introduced. Many of these large producers are centred outside of Saskatchewan and have reduced their Saskatchewan tax liability through their income allocation practices.

The Government will continue to review its corporate tax policies to further this strategy of lower overall tax rates with a levelling of the playing field for businesses operating in the Province. This will provide a solid basis for economic development and diversification.

Saskatchewan's Personal Income Tax Reform

Personal income tax reform was initiated by Saskatchewan in 1985 because of the pressing need to return to a tax system that raised revenue in a fair and simple manner. Last year's paper continued this process by detailing the issues, problems and options in restructuring our tax system.

The Government believes that the tax system should be fair and simple while encouraging risk taking and the desire to become more productive in the work place.

Public consultation is an integral part of the reform process.

Public Consultation

During the past year, the Government has consulted with the people of Saskatchewan, special interest groups and other governments on the future direction of Saskatchewan's tax reform.

The views of Saskatchewan residents are varied. Each has a unique and thoughtful vision of provincial tax reform. However, virtually all respondents agree with the principles laid out in last year's paper.

There is a general consensus for a simpler and fairer tax system. There is also consensus that support for the family is a key element in the design of such a system.

Each of the four alternatives presented last year received some degree of support. The clear message is that certain objectives must be achieved:

- support for families must be continued and, if possible, enhanced;
- the tax system must be made simpler to improve the level of confidence individuals have in its integrity; and,
- all individuals must pay their fair share of tax.

Federal-Provincial Discussions

Saskatchewan has a Tax Collection Agreement with the federal government which requires federal approval to introduce provincial income tax changes.

To implement any one of the proposals outlined in last year's paper would require federal acceptance since Ottawa is responsible for the administration of the income tax system. Although the federal government has spent considerable time examining the Province's reform initiative, it has yet to agree to any change.

Other provinces have recognized the importance of Saskatchewan's tax reform initiative and are reviewing their income tax systems.

Saskatchewan will continue to work with the federal government and the other provincial governments in pursuit of a sound tax system for all of Canada.

Saskatchewan's Reform Alternatives

Last year's paper presented four reform alternatives: an independent tax system, a pure flat tax structure, a progressive flat tax structure and a marginal tax structure. Each of the alternatives generated a number of specific comments.

Independent Tax System

Opting out of the joint federal-provincial tax arrangement was generally thought to be too drastic a step; the co-existence of a federal income tax system and a separate provincial income tax system would be too complex.

This alternative will receive further consideration only if all other possibilities are exhausted.

Pure Flat Tax Structure

A pure flat tax structure would be much simpler than the current provincial income tax system. It would mean that a lower tax rate would be applied on earnings and investment, thereby providing an incentive to increase productivity and efficiency. This alternative would require the Government to use expenditure programs to achieve certain social and economic objectives that are normally achieved through the income tax system.

However, the majority of residents prefer a provincial income tax system that offers support for social and economic policies. The consensus is that the tax system should be both progressive and considerate of family circumstance.

Progressive Flat Tax Structure

Considerable interest was expressed in the progressive flat tax structure. Its principal advantage is that it permits a simpler application of provincial tax while lowering the tax liability for families. This feature was attractive to many people.

However, while acknowledging the need to support the family, some individuals expressed concern that this support may require an increase in the tax liability of single taxpayers.

Comparison of Tax Structure Alternatives

Proposed Tax Rates	Pure Flat Tax Structure	Progressive Flat Tax Structure	Marginal Tax Structure
	7.5% on all Taxable Income	15% on all Taxable Income; 5% Surtax on Taxable Income in excess of $50,000	10% ($0-$20,000) 15% ($20,000-$45,000) 20% (Over $45,000)

Proposed Tax Credits	Pure Flat Tax Structure	Progressive Flat Tax Structure	Marginal Tax Structure
Basic	$ 0	$ 1,350	$ 612
Married/ Equivalent-to-Married	0	1,350	510
Dependants under 19	0	150	239
Dependants over 18 and infirm	0	125	150
Age 65 and over	0	275	330
Disabled	0	275	330
Pension Income	0	8.5%	10%
Tuition Fees	0	8.5%	10%
Education Allowances	0	$5/month	$6/month
Charitable Donations	0	8.5%*	10%**
Medical Expenses	0	8.5%*	10%*
UI/CPP Contributions	0	8.5%	10%

* Charitable donations in excess of $250 per year would be permitted a 14.5% tax credit; medical expenses in excess of 3% of Net Income would be eligible for the tax credit.

** Charitable donations in excess of $250 per year would be permitted a 17% tax credit.

Marginal Tax Structure

Many people felt that the marginal tax structure would be preferable, since it is similar to the current tax structure. This option assures a progressive application of tax, while recognizing family circumstance in determining the tax liability. It is also simpler than the current provincial tax system.

Many individuals felt that Saskatchewan's tax system should be flexible enough to reflect the Province's evolving economic priorities. This option offers Saskatchewan the ability to respond to this challenge.

While no major concerns were voiced, questions were raised concerning the Province's interest in having its own marginal tax structure since it may add a degree of complexity to the tax form.

Future Of Personal Income Tax Reform

Saskatchewan will continue its work toward reform of the personal income tax system. Based upon public input, the Government's efforts will be directed toward further review of the progressive flat tax and the marginal tax structures.

The federal government's decision to respond slowly to Saskatchewan's personal income tax reform initiative will delay implementation of a new income tax system until at least 1990. Further delays by Ottawa would put in doubt the Province's ability to undertake income tax reform under the current federal-provincial arrangements.

However, this delay allows Saskatchewan to broaden the scope of provincial tax reform to include consideration of the federal National Sales Tax proposal.

National Sales Tax

While the Government of Saskatchewan has been actively presenting tax reform initiatives, the federal government has also been pursuing a major reform of its tax systems.

As part of this reform, the federal government presented, in its 1987 White Paper, three options to replace its outmoded Manufacturers' Sales Tax, including its preferred option, a truly national sales tax that would involve the participation of both the federal government and the provincial governments.

Last year, in *A Dialogue on Saskatchewan Income Tax Reform*, the Government of Saskatchewan stated that:

> *"... the Province will only enter into a national sales tax if there is clear and irrefutable proof that it will benefit the people of Saskatchewan and that it will in no way result in a shift of either economic activity or fiscal capacity away from the Province."*

During the past year, there have been ongoing discussions with the federal government on the many issues associated with the introduction of the National Sales Tax proposal.

The Government of Saskatchewan has not made a decision on whether to participate or not to participate in the National Sales Tax. The Government must learn more about the views of its residents concerning the tax and its application to Saskatchewan before making a decision.

This paper is intended to provide a basis for public discussion on the National Sales Tax proposal. It is intended as a means of informing the people of Saskatchewan about the federal proposal. The Government will undertake public consultations to ensure that all residents have an opportunity to voice their views and concerns.

There are advantages and disadvantages associated with the proposal. The Government of Saskatchewan, like its counterparts in the other provinces and the territories, must carefully weigh all the

factors before answering the question: to participate or not to participate?

Why It Is Being Considered

The federal tax reform process has been divided into two stages.

Stage I involved a significant broadening of the income tax bases accompanied by a general lowering of both corporate and personal income tax rates. This Stage was introduced for the 1988 taxation year.

Attention has now shifted to Stage II which focuses mainly on the replacement of the federal government's outmoded Manufacturers' Sales Tax.

This tax has evolved into a complex web of exclusions and exemptions. Now, only about one-third of all goods and services consumed in Canada are directly subject to the tax. Concessions that were originally introduced as incentives to encourage the priorities of the national government have created a number of problems.

- Complexity - The myriad of exclusions and exemptions facing businesses causes a significant degree of administrative complexity. The tax has four rates, depending upon the product, and applies to a variety of different tax bases. Businesses waste time and energy in determining their products' tax status.
- Competitiveness - The differing ways in which the tax applies to various products actually means that the current system favours imported goods over domestically-produced goods. This results in a significant competitive advantage for foreign producers.
- Capacity - As a result of the narrow tax base, the federal government has had to resort to increased tax rates to generate the required amounts of revenue from the tax. Higher tax rates lead to decisions by businesses to structure their activities so as to avoid the tax.

The narrow tax base, combined with the necessity for high tax rates, causes, directly and indirectly, distortions in both consumer spending and business investment.

In examining alternatives for the replacement of the Manufacturers' Sales Tax, the federal government considered a number of options, including a federal Goods and Services Tax and a federal Value-Added Tax. After consultations with the provinces, the federal government proposed the introduction of a joint federal-provincial tax, the National Sales Tax. This proposal is currently the subject of federal-provincial examination.

The National Sales Tax follows the general strategy of Stage I of federal tax reform in that the tax base would be broadened so that the tax rates could be lowered.

From the federal perspective, the National Sales Tax resolves the problems associated with the Manufacturers' Sales Tax. It will be less complex since there will be fewer exemptions and the calculation of the tax will be straightforward. The similar treatment of imports and domestically-produced goods, combined with an exemption for

exports, will improve Canada's competitiveness in the world economy. Revenues from the tax will grow as the economy grows.

Proposed Design

The National Sales Tax will be a single-rate, broadly-based tax which will apply to all taxable domestic consumption in Canada at the time of purchase. It will replace the Manufacturers' Sales Tax and the sales taxes in the provinces which choose to participate in the tax.

The tax base of the National Sales Tax will include most goods and services consumed in Canada. It will be much broader than the base of the Manufacturers' Sales Tax and broader than the bases of the current provincial sales taxes. The National Sales Tax will permit a combined federal-provincial rate lower than the combined rates of the Manufacturers' Sales Tax and the current provincial sales taxes.

The National Sales Tax should not be considered a new tax. It will replace existing taxes. While most people in Canada are fully aware of the provincial sales taxes applied on retail sales, since these are highly visible taxes, fewer people are aware that the Manufacturers' Sales Tax also applies to the purchases they make. It is currently invisible to consumers since it is collected at either the manufacturers' or the wholesalers' level. Although the Manufacturers' Sales Tax does not apply directly to many products, it does apply to many of the inputs that contribute to the manufacture of those products. In this way, it becomes imbedded in the prices of goods and services.

The National Sales Tax will apply at each stage of the production-distribution cycle. It will be levied at a combined federal-provincial rate on the purchase price. Tax collected on purchases made at pre-retail levels will be refunded. Tax is levied and collected as goods move from primary producers to manufacturers and processors, to wholesalers, to retailers and, finally, to consumers. This ensures that the tax will not be hidden in the final retail price paid by end consumers.

Impact Of The Tax

The introduction of the National Sales Tax, with its broad base that includes most goods and services, will have an impact upon all sectors of the Canadian economy. The impact will vary from sector to sector and, in many cases, from product to product. While much of the discussion of the tax will focus upon the broadened tax base, the base-broadening is accompanied by tax rate reductions.

How individual consumers are affected by the National Sales Tax will depend upon a variety of factors. Certain goods, such as automobiles, appliances and furniture, are expected to experience a fall in price. Other products which currently experience only indirect application of tax, such as most services, may face some rise in price.

The ultimate impact of the National Sales Tax on consumers will also depend upon other circumstances, including the spending habits of individuals, the specific application of the tax and the tax rate. As well, the federal Minister of Finance has promised to remove the federal income tax surtaxes and has also promised to enrich the federal refundable Sales Tax Credit.

The impact of the National Sales Tax upon the business community will also be varied.

The removal of tax on business inputs, both federally and provincially, will be a benefit. On the other hand, more businesses will be involved in the collection of the tax since the National Sales Tax applies at all stages of the production-distribution cycle.

Businesses will benefit from the removal of sales tax on their exported products. Canada has long been disadvantaged in the export market because of the application of sales tax. Many foreign countries operate a tax system that is similar to the National Sales Tax and those countries permit the tax to be removed once a product enters the international market.

Exporters will no longer have the Manufacturers' Sales Tax imbedded in the price of their products. Canadian firms will be in a more competitive position both domestically and internationally. However, businesses that benefit from the current tax bias in favour of imported goods will be adversely affected.

The introduction of the National Sales Tax could play a significant role for Canada in taking advantage of new trade opportunities such as those offered by the Canada-United States Free Trade Agreement.

National Sales Tax Issues

There are a number of issues which must be resolved prior to a final decision being made on provincial participation. The Government of Saskatchewan is interested in learning the public's views regarding these issues.

Definition Of The Tax Base

Although a final decision on the definition of the National Sales Tax base has not been made, an essential aspect of the tax is that it is intended to apply to virtually all goods and services.

At present, only basic groceries and essential government services, such as medical care (including prescription drugs) and education, are proposed as exemptions.

There is also a commitment that municipalities, universities, schools and hospitals will not pay more under the National Sales Tax than they pay under the current tax systems.

If a substantial number of exemptions are permitted, a host of problems may result, including complexity, distortions and high tax rates. There are indeed pressures for further exemptions.

A critical question will be the extent to which any issues encountered under a broadened tax base can be dealt with through expenditure policies. Specific expenditure initiatives could be undertaken to deal with these issues rather than introducing further erosions to the tax base. For example, in response to concerns expressed about the application of the tax to new houses, the federal Minister of Finance has assured Canadians that the National Sales Tax will not affect the affordability of housing in Canada.

In addition, clarification of what constitutes basic groceries, prescription drugs and exempt government products is also still

pending. The federal government's approach to these and other issues remains unclear at this time.

Policies To Assist Small Business and Farmers

It is generally agreed that small business is a key sector for the successful introduction of the National Sales Tax. With this in mind, the federal government has proposed a series of measures designed to meet the concerns of the small business community about additional administrative costs associated with the National Sales Tax:

- an exception for small vendors, which will exempt over one-third of all commercial enterprises from collecting tax;
- a commission structure, which will offset administrative costs; and,
- flexible reporting periods, which will minimize the smaller or seasonal business's compliance effort.

These proposals to reduce the compliance costs of small business are an integral element of the National Sales Tax. Additional work is required to determine the exact nature of these measures.

The federal government is working on proposals for the treatment of purchases and sales by farmers in light of the decision to exempt basic groceries from the National Sales Tax. These proposals are expected to acknowledge the cashflow problems associated with farming and the export-oriented nature of the farmers' products.

Saskatchewan will continue to discuss these options with the federal government.

Effect On Families

The federal Minister of Finance has committed his government to ensuring that the National Sales Tax will be applied fairly.

Concerns have been expressed that the National Sales Tax will apply to essentials. Part of these concerns focus upon a potential for a shift in tax liability toward lower income families, which spend a greater proportion of their income on essentials.

The federal government's strategy to meet the commitment to apply the tax fairly has two major elements: the introduction of a limited number of base exemptions, particularly the exemption for basic groceries; and, the enrichment of the refundable Sales Tax Credit, which will be targeted at lower and middle income families.

The Government of Saskatchewan is a strong advocate of protecting the family and it will not abandon this position of protection for the family during its examination of the National Sales Tax proposals.

Impact On The Economy

The National Sales Tax proposal provides Canada with an opportunity to participate in a tax system which is similar to those used by many other nations in the world. A similar tax is required for membership in the European Economic Community and New Zealand has recently replaced a tax similar to the Manufacturers' Sales Tax with a Value-Added Tax.

Saskatchewan and other provincial governments are also faced with a similar choice of replacing their provincial sales tax systems with participation in the National Sales Tax.

The impact of the National Sales Tax on the provincial economy is a key consideration in the Province's decision to participate in the tax. Saskatchewan continues to examine the overall impact of the tax on the provincial economy with the viewpoint that the Government will not support its introduction unless it is good for Saskatchewan.

Future Of The National Sales Tax

It is expected that the federal Minister of Finance will table in Parliament more information pertaining to the National Sales Tax in the near future.

The Government of Saskatchewan is interested in learning the public's views on the National Sales Tax and its application to Saskatchewan. The Government is prepared to meet with interested parties to discuss any aspect of the proposed National Sales Tax.

Conclusion

For tax measures to be successful, they must contribute to the achievement of the principles of a sound tax system. Each isolated tax measure must, when integrated with the rest of the Government's tax measures, result in an improvement in the tax system's effectiveness and efficiency.

Saskatchewan's own tax reform initiative and the federal National Sales Tax proposal together are providing the Government of Saskatchewan with the opportunity to examine its major taxes, both in the income tax and consumption tax fields, in a coordinated fashion.

This is both a challenge and an opportunity.